

David Wright, IOSCO



David Wright, secretary-general at the International Organisation of Securities Commissions (IOSCO), believes regulators must identify problems faster and come down on transgressors harder.

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**How do you see the role of IOSCO within the regulatory framework of global financial markets? What are your priorities on joining IOSCO?**

IOSCO is the only global financial regulatory organisation which brings the market regulators across the globe together. We have around 200 members and about 120 of them are regulators of different nations. We continue to have important responsibilities in the context of global financial market repair as mandated by the Group of 20 (G-20) and Financial Stability Board (FSB). We are into the sixth year of the global economic crisis and we still have a lot of work to do, including new and emerging areas. The three key ones right now are: to make sure resolution frameworks are implemented effectively; to address the very complex nexus of issues around shadow banking; and to complete the OTC derivatives market reforms. At the same time, we are also seeing a number of new issues like the LIBOR scandal, issues arising from inadequate levels of sanctions and deterrence in global financial markets, and also poor corporate governance in many financial firms. We need to

deepen our cross-border co-operation to ensure these reforms can be implemented effectively. IOSCO is also involved in other areas, such as oil pricing reporting, the credit default swaps (CDS) market, and monitoring credit rating agencies.

I also think it's very important IOSCO works more to identify risk in the financial system. Our value-add as an international organisation is to identify, take a position and define global principles on new issues as early as possible, from which national and regional law can later be drawn up.

The world is moving towards a more securities-based financial system. Banks have capital constraints and leverage will be reduced. The public sector will also have capital constraints for decades ahead because of the strain on deficits and ageing populations in the Western world. Hence global securities markets are going to play a key role and developing them would be very beneficial. We are also in the process of developing an IOSCO

“There is still a lot of abuse in the securities market.”

foundation, which is a charitable institution to help emerging markets develop their securities market to high standards by imparting research, training and education, and technical assistance. This would in the long run prove beneficial and help the global economy.

**What role did regulatory failings play in the crisis and how far have these been rectified?**

The large, interconnected financial firms that fell during the crisis and the resulting financial chaos and uncertainty have brought the global GDP down by 10-15%. Everyone would agree the levels of capital in the banking system were inadequate. Hence there have been the Basel reforms to strengthen capital and raise the quality of capital. In addition, the Bank of England has piloted superbly the work on resolution. The key policy there is to be able to take out the failed or failing financial firms and either restructure them without the public purse or contagion or just remove them to the corporate graveyard without economic damage. I sense that for the first time, the world is moving to the logic of bail-in, which I feel is the only policy

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## The regulator's regulator



David Wright took up his current role at IOSCO in March this year, having spent over 30 years at the European Commission, most recently serving as senior advisor and member of the Commission's task force on Greece. Wright played a key role in the integration of Europe's financial services and capital markets. As well as his involvement in the drafting of MiFID and the recent

transparency, prospectus and market abuse directives, Wright represented the Commission in the G-20 and similar international fora.

IOSCO was formed in 1983 to promote cooperation among financial market supervisors and develop international standards and best practice. Since the global financial crisis, the G-20 and the Financial Stability Board have called on IOSCO to provide reports on a wide range of topics including shadow banking, oil pricing and the credit default swap market. In 2012, IOSCO has produced research and recommendations on financial market surveillance, money market funds, resolution of financial market infrastructures, and several aspects of the reform of the OTC derivatives markets.

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that can work and which is the only policy that is fair.

There has also been progress on enhanced discipline of credit rating agencies' conflicts of interest. But there are areas in particular that need further attention. Although there are exceptions, sanctions regimes at the global level clearly do not provide sufficient levels of deterrence. Sanctions regimes need to be much,

much tougher for all types of financial offence. There are far too many scandals, such as LIBOR, frequent mis-selling, financial fraud of various forms or money laundering.

A second area of regulatory failing is corporate governance. If you look at all the firms that failed, you can see that they were run by people who weren't fit for the purpose. We've also

seen weak boards, poor risk management capabilities and auditors who just ignored the warning signals. Corporate governance needs much more emphasis, with regulators paying much more attention to the quality of people running financial firms and even raising questions about the board members if needed, or vetoing appointments. I think it's right, for example, that the UK's Financial Services Authority is now vetting people for board positions. Shareholders have failed to do it so I think it's a regulatory responsibility.

Securities regulators can impose administrative fines, but usually these simply aren't strong enough. Criminal sanctions require a different set of legal procedures. In the US, the rules for conviction are that the Securities and Exchange Commission (SEC) only needs the balance of evidence on its side. There is no need for 100% proof of cause and effect, but that is not the case in other parts of the world. Until and unless there are much tougher sanctions, so people think twice before they commit major fraud in the financial market, we will just keep seeing more cases.

**IOSCO has prepared a consultative paper on resolution and recovery of banks and financial market infrastructures (FMIs). What are the next steps?**

We published this consultative paper in July and the comments are due by end of September and there will be a follow-up paper, which will be published by the end of the year. This will include methodology for assessing compliance with the key attributes asserted by the FSB in 2011, which require that jurisdictions establish regimes to allow for the resolution of a financial institution in circumstances where recovery is no longer feasible.

The report intends to outline the issues that should be taken into account for different types of FMIs when putting in place effective recovery plans and resolution regimes that are consistent with the principles and key attributes we have laid out. This is tremendously important because the fall of an FMI could lead to severe systemic disruption. We need strong co-ordination, co-operation amongst authorities, good principles and robust arrangements because FMIs

are clearing and settling huge volumes of trades from all over the world. After we have drawn the principles, we need strong monitoring and assessing measures. We need all tools in the soft toolbox to try and get these principles agreed.

**You make reference to the 'soft toolbox' which sounds like using influence and principles rather than legislation. Can you go in detail?**

At the global level, financial services rule-making is all about drawing principles and recommendations because there is no binding law. There is no legal instrument to impose these rules. That is why I used the term 'soft toolbox'. There is a special group in FSB and an assessment committee in IOSCO who will monitor the implementation of all our recommendations. We can use peer pressure, transparency and all sorts of other means but there is no binding law. However in some cases things have started changing. For example, in the European Union, if the Council of Ministers agrees

on something, or in the US the SEC or Commodity Futures Trading Commission adopts a formal rule it is a law. Rules are implementable by a certain date and in the EU the Commission can launch infringement procedures against any member state that does not abide by it. Ultimately, a country could be taken to the European Court of Justice in Luxemburg and face huge fines if it refuses to comply. But at the global level there are no such enforceable tools.

**What difficulties do issues of extraterritoriality raise from an enforcement point of view and in terms of regulatory co-ordination and co-operation?**

Whenever one country or jurisdiction applies a law that directly affects the laws of another country, market participants are faced with blatant conflicts of law. This is not only inefficient, but also costly and can lead to legal uncertainty. For example, the US Sarbanes Oxley Act required the Public Company Accounting Oversight Board to carry out inspections of European audit firms which

**"The firms that failed were run by people who weren't fit for the purpose."**

audited the European subsidiaries of companies listed in the US. This is similar to the problem we have now with OTC derivatives. One might argue there is an extraterritorial dimension to Europe requiring other jurisdictions to have equivalent laws, albeit that term can perhaps be taken too literally. Avoiding conflicts of law is essential in future. Right now we don't have that many large capital markets globally, but we may well have in ten or 20 years. Unless we come to grips with these conflicts of law through enhanced cooperation the problems are only going to get worse and more complex. Today we have no legal means of global dispute settlement.

**Are you confident the migration of OTC derivatives to a new framework will help in reducing systematic risks for those instruments?**  
I think it definitely will. The FSB, the G20 and IOSCO were all part of designing the new derivatives framework to reduce systemic risk and I'm confident it will have that effect. However regulators need to ensure that while drawing up these new disciplines, business doesn't migrate away from clearing

**“The world is moving towards a more securities-based financial system.”**

houses or trade repositories to a parallel form – similar to what happened in the context of shadow banking. Regulators need to be attentive and alert to avoid such slippage from the required disciplines. But while there are unresolved issues, this is one area that has seen some significant convergence of basic thinking. Issues of extraterritoriality notwithstanding, the jurisdictions of Europe and US – which trade 70-80% of the world's derivatives – are following broadly similar approaches.

**In an uncertain economic outlook, is there a legitimate concern that too strict a regulatory regime can negatively impact on innovation, growth and supporting the wider economy?**  
When you have a massive financial crisis like this one there is always a risk the regulatory tiller is jerked too far in one direction. Hence it is very important to carry out analytic studies on the economic and market impacts

of regulation. Regulators have to be very attentive on the effects on liquidity and collateral. However, financial innovation is very important and should not be choked off but innovations like CDO-squared didn't do us much good. Where the securities markets, in particular, can innovate beneficially is in designing new types of instruments for small- and medium-sized enterprises (SME). The SME sector creates the most growth and jobs, but small and medium-sized firms are squeezed a lot by the new capital rules. Whether through SME corporate bond markets or some other mechanism, new ideas and new thinking are needed to help small companies that are transparent and comply with international accounting standards raise money without necessarily moving through the IPO process.

**Are regulators using the existing market surveillance tools and resources effectively enough?**

I believe there is still a lot of abuse in the securities market, from insider trading, collusion, anti-competitive behaviour, money laundering or mis-selling. My personal view is the levels

of deterrence are not strong enough and I think the public agrees. At IOSCO, we will start to map out our members' sanctions regimes, see how different they are and try to get all ships to rise on the tide.

Regulators need to identify issues as early as possible. We're never going to be able to resolve all market manipulation, but in future people who undertake serious abuse of this kind should be fully aware that if they get caught they may well go to prison. Regulators need to use the whole panoply of tools, including technology but also making it easier for people to come forward and whistle blow. If you look at anti-competitive, price-fixing, collusion cases in Europe, for example, they are often brought to light by a whistle blower. Regulation is costly and resources are always scarce, but my personal observation is that enforcement divisions of regulators are rarely sufficiently well staffed, with a toolbox that is too constrained.

**How do you rate the benefits to investors since Europe introduced greater competition via MiFID?**

Having been very involved in MiFID, I think it was a pioneering attempt to introduce more competition, transparency and investor protection in the financial markets. It did have the effect of increasing cross-border trading in Europe and was very positive overall. Now there are new challenges, such as high-frequency trading, dark pools, so I feel the improvements the Commission is seeking are quite natural. As markets, technology and products evolve, the law has to make continuous improvements. Currently there is some updating of MiFID and I hope the outcomes will be measured, pro-competitive and provide a deeper and more effective intermediation of savings for the European economy. As I said earlier, the world is moving to a greater reliance on securities markets so it is very important that Europe gets MiFID right.

Clearing interoperability is important because the benefits of being able to net positions across different markets and products can be really significant. I hope that the ability to do so will not be thwarted by over-protectionism. Europe is bumping forward and

although the bumps in the road have been bigger in the last couple of years there are signs of progress. Banking union would have been unthinkable a couple of years ago but now the European Central Bank is going to take a very significant role in regulating and supervising banks. Overall, we are moving in the right direction. There's no such thing as perfect regulation but the more it is founded on strong economic principles and a full understanding of the consequences, the better the world will be.

**Is there anything else you'd like to see from the industry?**

We need great leaders in the industry for whom principles, ethics and vision really count. I urge the industry to play a much wider role in shaping the future. Industry folk should come forward and talk to regulators and IOSCO if they see any obvious risk before any systemic damage occurs. I want far more serious contributions from industry leaders in this regard. I have not seen a major thought-provoking, visionary speech or statement from a financial industry leader for a very long time.